Supreme Court, U.S.
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No. 96-914

In The

Supreme Court of the United States

October Term, 1996

JO MINOR,

Petitioner,

vs.

PRUDENTIAL SECURITIES, INC. and PATRICE MACKIE,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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COUNTER STATEMENT OF QUESTIONS PRESENTED

The two questions presented by petitioner are inappropriate under the criteria outlined in Rule 10 of the Supreme Court Rules, since they are not implicated by the record below. The record below does support the following questions:

1. Whether the Federal Arbitration Act — which provides that "the United States court in and for the district wherein the award was made may make an order vacating the award" — means instead that unless a case was already pending there, a United States court may *only* make such an order in diversity cases.

2. Is a federal question presented for purposes of federal jurisdiction under 28 U.S.C. § 1331 solely because the arbitration underlying the petition to vacate included federal claims.[1]

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1. In accordance with Supreme Court Rule 29.6, respondent Prudential Securities Incorporated states that it is a Delaware corporation with its principal place of business in New York, New York. Prudential is a wholly owned subsidiary of the Prudential Insurance Company of America.

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COUNTER STATEMENT OF THE CASE

In accordance with Supreme Court Rule 15.2, a Counter Statement of the Case is necessary because the Petition recites as "fact" many assertions which are not part of the record, were not considered below and, in part, are factually untrue. Contrary to the impression conveyed by the Petition, the underlying facts and circumstances are simple, straightforward and should not be controversial:

Jo Minor ("Minor") was a securities customer of Prudential Securities Incorporated ("Prudential"), a broker-dealer; her broker was Patrice Mackie ("Mackie"). On December 6, 1993, Minor filed a claim in arbitration before the National Association of Securities Dealers, Inc. against Prudential and Mackie. Prudential and Minor were subject to a pre-dispute arbitration agreement contained in Minor's securities account agreement with Prudential.

Minor's arbitration Claim asserted nine different counts including alleged violations of the state and federal securities laws, common law tort, common law contract and "RICO." Although the RICO claim was withdrawn prior to the hearing, Minor's securities fraud claims under the Securities Exchange Act of 1934 were heard by the Arbitrators.

Prudential and Mackie denied the claims, and, after a protracted hearing, the Arbitrators denied Minor's claims in their entirety and entered an award dismissing each claim. Thereafter, Minor sought and received an extraordinary "Statement of Reasons" from the Arbitrators explaining the reasons for the denial of her claims.[2] Minor, nonetheless, states in her Petition

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2. The Statement of Reasons provided by the Arbitrators, in fact, belies the same precise allegations which later became the factual assertions in (Cont'd)

that certain documents and putative testimony (concerning the alleged forgery of her new account agreement) were hidden from, and/or ignored by, the Arbitrators. In fact, her specific claims of procedural wrongdoing were presented to the Arbitrators and she received additional discovery because of them. Her substantive claims were, however, subsequently denied on the merits.

On February 7, 1995, Minor filed a Petition to Vacate the Arbitration Award in the United States District Court for the Northern District of Illinois. Prudential and Mackie asserted a Motion to Dismiss pursuant to Rule 12(b) of the Federal Rules of Civil Procedure for lack of federal subject matter jurisdiction. On December 26, 1995, Judge Brian Barnett Duff granted that Motion and dismissed Minor's Complaint. Thereafter, on March 3, 1996, Minor appealed that decision to the United States Court of Appeals for the Seventh Circuit which, on September 4, 1996, denied the appeal. This Petition followed.

REASONS FOR DENYING THE WRIT

The Court of Appeals' decision does not present any question which warrants review by this Court. That decision reaffirmed and applied well-settled authority that, although the Federal Arbitration Act (the "Act") evidences a strong federal policy favoring enforcement of agreements to arbitrate, the Act is not, itself, a basis for federal jurisdiction. Rather, in order for an arbitral dispute to be heard in federal court, either diversity jurisdiction, under 28 U.S.C. § 1332, or federal question jurisdiction, under 28 U.S.C. § 1331, must be present in the petition which is submitted to the court for decision.

(Cont'd)

Minor's Petition to Vacate. The Arbitration Award and the Arbitrators' Statement of Reasons are set forth in the Appendix to this Brief, as Appendix A and B, respectively.

A petition to vacate an arbitration award, ultimately, implicates only Section 10 of the Act, even if the underlying arbitration included federal questions. The "reviewing court" does not review the award to determine if it agrees with the arbitrators' assessments and findings of fact and any explicit or implicit conclusions of law. Rather, the review is solely to determine if a violation of the standards set forth in Section 10 of the Act has occurred. Accordingly, a petition to vacate an arbitration award may only be heard in federal court if (i) there is diversity jurisdiction under 28 U.S.C. § 1332 or (ii) there was a prior lawsuit in that court which addressed a motion to compel arbitration of the underlying dispute.

I.

A PETITION TO VACATE AN ARBITRATION AWARD MUST SUPPLY AN INDEPENDENT BASIS OF FEDERAL JURISDICTION.

It is well settled that the Act, although a federal statute embodying a strong federal policy favoring enforcement of agreements to arbitrate, does not supply an independent basis for federal jurisdiction:

> The Arbitration Act is something of an anomaly in the field of federal court jurisdiction. It creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate, yet it does not create an independent federal question jurisdiction under 28 U.S.C. 1331 or otherwise.

Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 25 n. 32 (1983); *see also Southland Corp. v. Keating*, 465 U.S. 1, 9-11 (1984).

When a court reviews a petition under the Act, the issue which it is being called upon to decide (in the absence of diversity among the parties) determines whether federal question jurisdiction under 28 U.S.C. § 1331 is present. If the court is being asked to determine if an arbitration award was, for example, "procured by fraud," it is not considering or determining a federal statute. On the other hand, if it is being asked to stay and compel arbitration of a lawsuit which alleges violations of the Securities Exchange Act of 1934, the lawsuit was already properly in federal court pursuant to 28 U.S.C. § 1331.

Contrary to Minor's argument, this Court, as well as the Courts of Appeals for the various circuits and all reviewing District Courts, have interpreted the Act consistently and have opined contrary to the position which Minor asserts in her Petition. As discussed above, the Act creates a body of federal substantive law favoring enforcement of arbitration agreements which must be enforced by state and federal courts alike; but, it does not itself create federal question jurisdiction.

Minor misapplies a familiar doctrine, the "well pleaded complaint rule," in her argument that federal question jurisdiction is present any time that a court is called upon to consider a post-arbitration petition under the Act, so long as the underlying arbitration involved federal claims. This is incorrect: When a United States District Court considers either a motion to dismiss for lack of subject matter jurisdiction or a removal petition, under 28 U.S.C. § 1441, it looks not to the answer or to the removal petition to determine if federal question jurisdiction is present, but to the underlying complaint. This is because the court will be called upon, should the motion to dismiss be unsuccessful (or the removal petition successful), to decide the issues presented in the complaint.

However, when considering a petition to vacate an arbitration award under the Act, the court will consider only the matters alleged in the petition to vacate in order to determine if Section 10 of the Act had been violated. The court will not consider or determine the substantive issues contained in the underlying arbitration. The Court of Appeals for the Second Circuit recently confirmed this analysis in a case involving Section 4 of the Act. *Westmoreland Capital Corporation v. Findlay, et al.*, 100 F.3d 263 (2d Cir. 1996).

This Court has recognized that neither the Act nor its legislative history are entirely clear. *Southland*, 465 U.S. at 12. Lower federal courts have also noted these ambiguities. *Merrill Lynch, Pierce, Fenner & Smith v. Lauer*, 49 F.3d 323, 329 (7th Cir. 1995) (referring to a "sketchy and incomplete" legislative history); *Harry Hoffman Printing, Inc. v. Graphic Communications, Int'l. Union, Local 261*, 912 F.2d 608, 611 (2d Cir. 1990) ("This language [referring to Section 10 of the Act] is less than precise. . . ."); *Drexel Burnham Lambert, Inc. v. Valenzuela Bock*, 696 F. Supp. 957, 960 (S.D.N.Y. 1988) ("The problem is, in part, one of bad statutory drafting .. . [referring to the use of the term 'the United States court' in the Act]").

The absence of a lengthy or clear legislative history does not mean, however, that the various courts have ruled inconsistently. Petitions under Sections 3 and 4 of the Act *are* treated differently than petitions under Section 9, 10 and 11, but not because the courts have acted and ruled inconsistently. Rather the courts have created a single *de facto* test: Whether the issue for the court to decide (whether contained in a petition to compel arbitration or a petition to vacate an arbitration award) substantially involves a federal question. In fact, the Second Circuit, in *Westmoreland*, recently concluded that Sections 4, 9 and 10 of the Act are treated in the same manner:

> If the language of FAA § 4 were interpreted to give federal courts jurisdiction to compel arbitration whenever the underlying claim involves a federal question, this would produce an odd distinction: a petition to compel arbitration could be brought in federal court, but a petition under FAA §§ 9 or 10 to confirm or vacate the arbitration award in the same dispute could not. This distinction would truly be "bizarre". . . .

Westmoreland, 100 F.3d at 268.

When reviewing a petition to compel arbitration, the reviewing court must determine from the underlying complaint if there is a basis for federal jurisdiction. The petition does not independently supply a grant of federal jurisdiction. No such analysis is required in connection with a petition to vacate, as the only substantive inquiry is whether the arbitration was conducted (and any award obtained) in violation of the standards set forth in Section 10 of the Act. *Harry Hoffman*, 912 F.2d at 611; *City of Detroit Pension Fund v. Prudential Securities, Incorporated,* 91 F.3d 26, 29 (6th Cir. 1996); *Ford v. Hamilton Investments, Inc.*, 29 F.3d 255, 257-58 (6th Cir. 1994); *Merit Insurance Company v. Leatherby Insurance Co.*, 714 F.2d 673 (7th Cir. 1983).

II.

THE PURPOSE OF THE ACT IS NOT TO REVIEW ARBITRATION AWARDS.

On numerous occasions, this Court has considered the legislative history of the Act. It is well-settled: "First, the basic purpose of the Federal Arbitration Act is to overcome courts'

refusals to enforce agreements to arbitrate." *Allied-Bruce Terminix Companies, Inc. v. Dobson,* 513 U.S. __, 130 L. Ed. 2d. 753, 762, 115 S. Ct. __ (1995); *Scherk v. Alberto-Culver Co.,* 417 U.S. 506, 510-11 (1974); *Shearson/American Express Inc. v. McMahon,* 482 U.S. 220, 225-26 (1987) :

> Congress' clear intent in the Arbitration Act was to move the parties to an arbitral dispute out of court and into arbitration as quickly and easily as possible.

Moses H. Cone, 460 U.S. at 22 (1983).

Conversely, the purpose of the Act was **not** to create new federal court jurisdiction merely because an arbitration agreement was involved. "Congress has given the lower courts jurisdiction to hear only those cases in which the plaintiff's right to relief necessarily depends on substantial question of federal law." *Franchise Tax Board v. Laborers Vac. Trust,* 463 U.S. 1, 27-28 (1983); *see also Moses H. Cone,* 460 U.S. at 24 (1983).

Accordingly, although the Act does provide, in Sections 9, 10 and 11, a statutory basis on which to petition a court of competent jurisdiction to affirm, vacate or modify an arbitration award, such petitions do not, of themselves, implicate the purpose of the Act. In this respect, a federal court's jurisdiction to hear a post-arbitration petition rests on principles of judicial economy and should be viewed in the same context as a United States District Court considering a complaint which consists solely of pendant state law claims after any federal claims have been dismissed.

Under *United Mine Workers of America v. Gibbs,* 383 U.S. 715 (1966), once the federal court has dismissed all federal law claims, it has discretion to retain jurisdiction to hear pendant

state law claims only when the case has advanced substantially and the court has invested time in connection with the merits of the case. In context, in the absence of diversity jurisdiction, a petition to vacate (or one to confirm or modify) an arbitration award may only be heard in a federal court if a case was already properly brought in that court and a motion to compel arbitration pursuant to Sections 3 or 4 of the Act had been previously granted.

It is equally well-settled that Sections 3 and 4 of the Act do not provide an independent basis of federal jurisdiction. "Hence there must be diversity of citizenship or some other independent basis for federal jurisdiction before the order can issue." *Moses H. Cone,* 460 U.S. at 25, n. 32. Petitioner cites *Harry Hoffman,* 912 F.2d at 611, n.1, but misses the point:

> [I]t would be anomalous to conclude, for example, that Section 4 confers no jurisdiction to compel arbitration, but that Section 10 confers jurisdiction to vacate an award once arbitration has taken place.

Harry Hoffmann stands for the proposition that the petition which the court will consider on the merits must include an independent basis of federal jurisdiction.

Moreover, it is highly unlikely that, in 1925, Congress intended Sections 9 and 10 and of the Act to constitute both *in personam* jurisdiction over a defendant as well as federal court subject matter jurisdiction. Under Section 12 of the Act (which supplies the procedural requirements for all post-arbitration petitions), service of the petition may be made on "the adverse party or his attorney as prescribed by law for service of notice of motion in an action in the same court." It would be unprecedented and extraordinary for parties to arbitrations to

be able to obtain *in personam* jurisdiction over the adverse party by serving the attorney who represented that individual in an earlier arbitration proceeding but where there had been no prior judicial proceedings.

On balance, it is clear that Congress, in providing for post-arbitration judicial proceedings, necessarily assumed that a prior action had been pending in the same court prior to the arbitration underlying the petition in question. The entire procedural structure, including treating the petition as a motion and providing for service on the opposing party by serving his attorney, confirms this construction: "A court [that] orders arbitration retains jurisdiction to determine any subsequent application involving the same agreement to arbitrate, including a motion to confirm [or vacate] the award." *Smiga v. Dean Witter Reynolds, Inc.*, 766 F.2d 698, 705 (2d Cir. 1985), *cert. denied*, 475 U.S. 1067 (1986); *see also Harry Hoffman*, 912 F.2d at 611.

Ultimately, as the Seventh Circuit has held in connection with this and with other cases, post-arbitration petitions, such as this Petition to Vacate, do not raise the policy concerns which underlie Congress' enactment of the Act. *Lauer*, 49 F.3d at 330 (7th Cir. 1995).

CONCLUSION

For the foregoing reasons and controlling authorities, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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APPENDIX A — ARBITRATION AWARD

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS

93-05044

Name of Claimant

Jo Minor

Name of Respondents

Prudential Securities, Inc. and Patrice A. Mackie

REPRESENTATION OF PARTIES

Claimant Jo Minor ("Minor") was represented at the hearing by Henry Field, Esq. of the Law Offices of Henry Field, Ltd., Chicago, Illinois.

Respondent Prudential Securities, Inc. ("Prudential") was represented at the hearing by Christopher M. Mone, Esq. of Prudential Securities, Inc., New York, New York.

Respondent Patrice Mackie ("Mackie") was represented at the hearing by co-counsel to Christopher Mone, William Holland, Esq. of Holland and Holland, Chicago, Illinois.

CASE INFORMATION

Statement of Claim filed on December 6, 1993. Response to Respondent's Motion to Dismiss the claim filed on or about March 24, 1994. Claimants' Submission Agreement signed on November 26, 1993.

Appendix A

Joint Statement of Answer and Motion to Dismiss filed by Respondents Prudential and Mackie on February 2, 1994.

Respondent, Prudential's Submission Agreement signed on July 20, 1994. Respondent, Mackie's Submission Agreement signed on July 13, 1994.

HEARING INFORMATION

Prehearing conferences were held on October 5, 1994 for one (1) session, December 2, 1994 for one (1) session, and on January 9, 1995 for one (1) session.

The hearings were held on December 14, 1994 for two (2) sessions, December 15, 1994 for two (2) sessions, and on January 17, 1995 for two (2) sessions in Chicago, Illinois.

CASE SUMMARY

Claimant Minor alleged the following Counts as her Statement of Claim: Count I, Breach of Fiduciary Relations, Count II, Breach of Contract, Count III, Fraud, Count IV, Constructive Fraud, Count V, Lack of Due Care in Performing Contract, Count VI, Illinois Securities Act, Count VII, Securities Act of 1934, Count VIII, RICO, 1962(a), Count IX, RICO, 1962(c).

Claimant further alleged in her Statement of Claim that Respondents Prudential and Mackie recommended high-risk investments such as Centocor, Inc., LSI Logic Corporation, and Glaxo Holdings, while representing that they were safe, forged Minor's signature on the Client Agreement, and engaged in at least one unauthorized trade. Claimant Minor also alleged that Prudential failed to supervise Mackie.

Appendix A

Respondents Prudential and Mackie (collectively "Respondents") in their joint Statement of Answer and Motion To Dismiss stated that Minor must be barred from pursuing her claim with respect to her purchase of Centocor, Inc. since she chose to participate in the Centocor class action. Respondents denied the allegations set forth in the Statement of Claim. Respondents stated that Minor was a sophisticated investor and was advised of any risks involved. Respondents also stated that Minor chose to purchase Centocor after Mackie recommended a selection of stocks, including Centocor. Respondents stated that Minor's name was not forged on the Client Agreement and that the burden of proof is Minor's responsibility.

Claimant Minor, in her Reply to the Motion to Dismiss stated that there are no duplicative claims. In Respondents Response to the Reply, Respondents stated that Minor's claim is not eligible for arbitration since she is a member of the Centocor class action.

RELIEF REQUESTED

Claimant requested compensatory damages in the amount of her loss ($17,797.86), plus interest from January 1, 1992 to the date of the award, treble damages amounting to $53,393.58, plus interest pursuant to 18 U.S.C., Section 1964(c), attorneys fees, filing fees and costs, and such other and further relief as claimant may request or the panel may order.

Respondents requested that the Statement of Claim be dismissed in its entirety.

OTHER ISSUES CONSIDERED AND DECIDED

The NASD administratively denied Respondent's Motion to

Appendix A

Dismiss based on Section 12(d)(2) of the NASD Code of Arbitration Procedure and stated that the parties may re-raise the issue with the panel. The motion was re-raised with the panel but subsequently denied.

Count VIII and Count IX of the Statement of Claim were withdrawn prior to hearing by Claimant.

The parties have agreed that the Award in this matter may be executed by counterpart copies or that a handwritten, signed Award may be entered. In either case, the parties have agreed to receive conformed copies of the Award while the originals remain on file with the NASD.

AWARD

After considering the pleadings, the testimony, and the evidence presented at the hearing, the undersigned arbitrators have decided in full and final resolution of the issues submitted for determination as follows:

1. Count I: The panel finds no breach of fiduciary relation;

   Count II: The panel finds no breach of contract;

   Count III: The panel finds no proof of constructive fraud;

   Count IV: The panel finds no proof of professional negligence;

   Count V: The panel finds no violation of professional negligence;

Appendix A

Count VI: The panel finds no violation of the Illinois Securities Act;

Count VII: The panel finds no violation of the Federal Securities Act;

Count VIII and Count IX were withdrawn prior to hearing;

2. Claimant's request for interest is denied;

3. Claimant's request for treble damages is denied;

4. Each of the parties shall bear their own costs and expenses, including attorney's fees, other than those specifically enumerated for under Forum Fees below.

FORUM FEES

Pursuant to Section 43(c) of the NASD Code of Arbitration Procedure, the following forum fees are assessed:

6 hearing sessions x $1000 = $6000 plus three (3) prehearing conference sessions x $300 = $900 equals net $6900 due to the NASD.

Pursuant to Section 43(c) of the Code, the NASD shall retain the nonrefundable filing fee in the amount of $250 previously deposited by Claimant.

The panel has ordered that Claimant, Jo Minor, pay the additional forum fees in the sum of $6900 to the NASD.

Appendix A

Additional forum fees assessed by the panel are payable to the National Association of Securities Dealers, Inc.

By the Arbitration Panel:

Dated:

2/28/95	s/s Richard L. Merrick Richard L. Merrick, Esq. Presiding, Public Arbitrator
3/1/95	s/s Michael F. Jordan Michael F. Jordan, Esq. Public Arbitrator
2/27/95	s/s Marc Horin Marc B. Horin Industry Arbitrator

Date Award Served by the NASD: (for NASD use only) 3/9/95.

APPENDIX B — ARBITRATOR'S STATEMENT OF REASONS

NASD Arbitration

National Asociation of Securities Dealers, Inc. • 20th Floor • 10 South LaSalle Street • Chicago, IL 60603-1002 • 312-899-1110 FAX 312-236-9239

TO: All parties

FROM: Sharon A. Kranz, Staff Attorney

DATE: April 18, 1995

Subject: NASD Arbitration Number 93-05044
Jo Minor vs. Prudential Securities, Inc. and Patrice A. Mackie

By letter dated March 9, 1995, counsel for claimant requested a letter from the panel which would provide reasons for their results in the above-captioned matter. The NASD Code of Arbitration Procedure does not currently obligate arbitrators to provide their findings to the parties. However, the arbitrators may decide on their own accord to provide such reasoning.

The arbitrator's findings are as follows:

In essence the Award exemplified the fact that claimant did not establish facts which would justify relief.

Jo Minor executed a brokerage account agreement with Prudential by signing a cash account customer's form of contract. She did not intend to have a cash account and did not ever consider that she had a cash account. She always treated it as a

margin account. Possibly a majority of the proof offered by the complainant in the case related to a margin account form of customer's agreement bearing the handwritten name Jo Minor on the signature line. You had two contentions with respect to this form:

(a) It was not signed by Jo Minor nor by any authorized agent of Jo Minor, and;

(b) The purported signature was a forgery executed by Patrice Mackie.

With respect to proposition (a), Jo Minor testified that it is not her signature and that she did not authorize anybody to sign her name. Her expert testified that it is not Mrs. Minor's signature. The opposing expert testified that it could be her signature. Thus, the issue is not resolved to a certainty, but the weight of the evidence suggests that it is not the signature of Jo Minor nor of an authorized agent.

With respect to proposition (b), with the exception of the rather weak testimony of the complainant's expert, there is so little to support the suggestion that the writing is that of Patrice Mackie, plus the almost infinite possibilities of who might have written the name, that no conclusion can be reached as to who write it. Your expert was much less persuasive than the expert for the defense. In that respect, you failed to prove a major contention of your allegations. In other words, if forgery had been an essential element of your case, you would have failed because you did not have a preponderance of the evidence in support of your position.

Under questioning by the arbitration panel, you conceded

that even assuming, arguendo, that the writing was a forgery, Jo Minor was not harmed by it because she had wanted a margin account and thought that she had a margin account. The only effect of the second customer's agreement was to permit the account to be treated as a margin account by Prudential, which it and she had been doing already.

Your contention that Jo Minor was an unsophisticated elderly widow was refuted by her own testimony, by her income tax return, and by her long history of fairly active trading in speculative common stocks with a large number of regular and discount brokers. The fact that she had losses in her account at Prudential does not create a liability on the part of Prudential unless it violated a responsibility to Mrs. Minor. None was established.

cc: all arbitrators